STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Illinois Bell Telephone Company	)	
Filing to increase Unbundled Loop and	)	
Nonrecurring Rates.	)	Docket No. 02-0864
	)	
(Tariffs filed December 24, 2002)	)	

INITIAL BRIEF OF THE PEOPLE OF THE STATE OF ILLINOIS

PUBLIC VERSION

PEOPLE OF THE STATE OF ILLINOIS
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TABLE OF CONTENTS

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The People of the State of Illinois, by and through Lisa Madigan, Attorney General of the State of Illinois ("the People") submit the following Initial Brief in the above captioned proceeding.

INTRODUCTION

I. Introduction and Summary of Position.

In order to ensure that SBCI's proposed UNE rates in this proceeding were accurate and not overstated, the AG contracted William Dunkel and Associates, a sole proprietor telecommunications consultant, to review SBCI's cost study. As a result of Mr. Dunkel's review, the AG sponsored direct testimony that identified double counted expenses as well as overstated costs and factors. SBCI made significant revisions to its cost study in response to this, and other testimony. One example of the impact of the AG direct testimony is found in SBCI's rebuttal testimony as follows:

> ..I agree there was inadvertent "double counting" as described by Mr. Dunkel...
> Upon review of Mr. Dunkel's testimony, however, the Company has determined that the costs associated with NIDs, drop wire and premises termination were not, in fact, removed for the cable installations factors, as Mr. Dunkel suggests.

SBCI Ex. 4.1 at 85. The exact impact of this and other revisions made by SBCI to their cost study in response to AG testimony will be discussed in greater detail in this brief. However, SBCI's response to the AG's testimony indicates that the AG's expert, Mr. Dunkel, understands SBCI's cost model and can speak authoritatively regarding necessary adjustments. Many of the suggestions made in testimony sponsored by the AG

have already been incorporated into SBCI's and Staff's revised proposed UNE loop rates. However, some suggestions have not been adopted. Accordingly, SBCI's, and to a lesser degree, Staff's revised proposed UNE rates remain overstated and additional adjustment are necessary.

Most significantly, the AG has pointed out, and the record in this proceeding clearly demonstrates, that the demand SBCI faces for telephone lines is *** .*** Even though demand is *** ***, SBCI, through its fill factor proposals, maintains that it is necessary to construct spare capacity in anticipation of future increases in demand. The demand ***I *** are not coming. There is no need to build excess capacity to prepare. Doing so will result in artificially high costs being passed on to CLECs through inflated UNE loop rates.

Additionally, SBCI's revised cost model continues to assign building costs to pay for buildings that do not exist. As will be discussed in greater detail herein, the SBCI "LoopCat" cost model assigns building costs to electronics equipment that SBCI admits is not located in a building. This overstated building cost must be removed in order for UNE loop rates to accurately reflect the costs they are supposed to recover.

Throughout the course of this proceeding, parties have provided several revisions to their models, costs and proposed rates. The AG has three recommended adjustments to the latest Staff model. Those three adjustments are:

1. Correct a data entry error in the Staff Buried Cable Metallic Installation Factor,
2. Remove Building costs from locations where there are no buildings, and
3. Use the forward-looking loop cable fill factors selected by the FCC for its forward-looking Synthesis Model (SM).

These three adjustments are shown in detail on Schedule WDA-RJ2, and the resulting rates and TELRIC costs are shown on Schedule WDA-RJ1. (Attached as Exhibit 1.) Additional discussion of these three adjustments is contained in the Surrebuttal Testimony of Thomas Regan. AG Ex. 1.3 at 4. These exhibits demonstrate that SBCI's proposed UNE loop rates are overstated and should not be approved.

II. General Issues.

A. Legal Requirements for Setting Rates:

The burden of proving the reasonableness of all rates and costs presented in this proceeding falls solely on SBCI. The ICC has specifically stated in previous SBCI UNE rate cases that, "Under the Illinois Public Utilities Act, it [Ameritech] and it alone, bears the burden of proving that proposed rates are just and reasonable. ." ICC Order 96-0486/96-0569 (consolidated), at p. 34 (February 17, 1998) cited in AG Ex. 1.0 at 49-50 See also 220 ILCS 5/9-201(c) ("the burden of proof to establish the justness and reasonableness of the proposed rates shall be "upon the utility.")

Accordingly, if SBCI presents a fill factor, and the support for that fill factor makes an unreasonable and unsupported assumption that demand is growing, when, in fact, the record clearly demonstrates that demand is *** ***, then SBCI has not met its burden of proof with regard to the reasonableness of that fill factor.

Similarly, if SBCI applies a building cost to equipment that is not located in a building and provides, as its only justification, the assertion that it knows of no way for its accounting system to remove the inappropriately applied building costs, then SBCI has not met its burden to show that the application of such a building factor is reasonable. The AG urges that when considering the costs proposed by SBCI in this proceeding, the

Commission to be cognizant that, under the PUA, the burden of proving the reasonableness of each cost presented lies with SBCI alone.

B. Economic/Policy Issues Associated With UNE Pricing (including benchmarking analyses and trends in communication costs):

1. The demand SBCI is facing for network lines is * . ***

A major assumption used by SBCI throughout this case is that demand for telephone lines is increasing. SBCI's cost models assume future network growth and include spare capacity, as part of the fill factor, to accommodate that growth. For example, in Access Area C (i.e. Zone 3), SBCI's proposed distribution fill factor for zone C of *** *** would result in ** ** distribution lines being installed per residence, despite the fact that SBCI's cost model assumes that only ** ** lines are in service per residence, on average, in Access Area C.[1] In adopting and modifying SBCI's cost models, Staff adopts a similar, but slightly reduced assumption. Staff's proposed fill factors assume between ** ** distribution lines will be installed per home, despite the fact that the cost model staff adopts assumes between *** *** lines in service per home is, depending on the zone. SBCI's proposed fill factors assume between ** *** to ** distribution lines will be installed per home. However, there is no factual basis for the assumption of future network growth that underlie these fill factors. To the contrary, the record demonstrates that the future demand SBC faces for telephone lines is * . ***

The clearest demonstration in the record that the demand SBCI faces is *** *** was provided by SBCI in response to a Staff data request that asked for SBCI's

[1] AG Ex. 1.3 at 16.

actual distribution network capacity and usage over the past several years by access area.[2] SBCI's response provided distribution network capacity and actual usage at the access area level for the years 2000–2003. AG Cross Exhibit 31P. As Staff witness Dr. Liu confirmed, this data clearly demonstrates that in each of SBCI's access areas, the number of actual lines in use in the distribution network has not grown from 2000 to 2003. TR at 1040, Ln. 18. In fact, as demonstrated in the table below, actual lines in use in the distribution network has *** *** slightly in each access area from 2000 to 2003:

Actual usage Of SBCI's Illinois Distribution Network From 200 – 2003 as reported by SBCI in response to Staff Data Request QL 4.10:

	2000	2003
Area A	*** ***	*** ***
Area B	*** ***	******
Area B	******	*** ***

Additionally, SBCI's 2002 Annual Report to Shareholders showed nationwide decreases of 9.15% for retail consumer access lines, and of 6.7% for business access lines in the year 2002 as compared to 2001. SBCI's total access lines declined 4.1%. Their lines in service also declined in the year 2001 as compared to 2000. AG Ex. 1.3 Schedule WDA-RJ7. Furthermore, SBCI's January 27, 2004 Investor Briefing noted, "on-going access line losses" in the fourth quarter of 2003. AG Exhibit 1.3 at page 11. SBCI's own testimony introduced in this proceeding by Dr. Lawrence K. Vanston demonstrates that access line numbers are declining as follows, "[S]ince 2000, the number of ILEC narrowband access lines (including UNE and resale lines) has been declining. This figure

[2] Staff Data Request QL 4.10.

peaked at 187.3 million in 2000, falling to 176.1 million in 2003…" SBCI Exhibit 13.1 at pp. 11-15.

Finally, data filed by SBCI with the Federal Communications Commission ("FCC") confirms what SBCI reported to shareholders and presented in testimony in this proceeding: access lines in service has fallen since 2000. The FCC's Automated Reporting Management Information System (ARMIS) data for Illinois Bell Telephone shows the total number of working loops declining each year since 2000. AG Ex. 1.3 Schedule WDA-RJ4.

Since, as demonstrated above, the record in this proceeding clearly indicates that SBCI's demand for distribution lines is not growing, there is no need to build more spare capacity into the distribution network that is already there to accommodate future growth. Accordingly, calculating fill factors to account for this non-existent future growth is improper and would result in significant inflation in the TELRIC rates determined in this proceeding. The forward looking fill factors contained in the AG's testimony (AG Ex. 1.3 at Schedule WDA-RJ5) should be adopted and used in determining rates in this proceeding in order to avoid setting rates that reflect an unrealistic expectation of future demand growth.

2. Since SBCI's costs in Illinois are low relative to other regions of the country, it follows that SBCI's wholesale rates should be correspondingly low.

a. SBCI's loop costs are the 5th lowest in the country.

SBCI's actual loop costs in Illinois are the fifth lowest of all States in the country. Correspondingly, SBCI's current rate per loop is the fifth lowest of all States. AG Ex. 1.0 Schedule WDA-3. The record clearly demonstrates that SBCI's relatively low loop costs correspond to the low cost characteristics of the majority of SBCI's serving area in

Illinois. AG EX. 1.0 at 5. As the FCC has acknowledged, a strong negative correlation exists between population density and the loop costs reported by costs models.[3] In other words, as a general rule, the more densely populated an ILEC's serving area is, the lower its loop costs will be.

The majority of SBCI's customers in Illinois are in the Chicago metropolitan area, which, obviously, as one the largest metropolitan areas in the country in terms of population, is a densely populated area. Specifically, 73% of SBCI's lines in Illinois are in areas with a population density greater than 1000 lines per square mile. For comparison, none of the Verizon Illinois central offices have a density greater than 1000 lines per square mile. 90% of SBCI's lines in Illinois are in areas with a population density of greater than 400 lines per square mile. AG Ex. 1.0 at 5. Since, as the FCC has found, high population density is correlated with low loop costs, it is no surprise, and is wholly appropriate that SBCI has low loop costs in Illinois.

b. SBCI's proposed UNE rates would be the highest in the country.

What would be surprising would be if SBCI charged high UNE rates when the underlying costs for those loops were among the lowest in the nation. Indeed, the UNE prices SBCI originally proposed in this proceeding would have, if adopted, resulted in SBCI's Illinois UNE rates being the highest in the nation. SBCI's final proposed UNE rates are lower, but would still be, if adopted, the 8th highest in the nation.[4] Allowing

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[3] AG Ex. 1.0 at Footnote 1 citing FCC Interconnection Order, FCC 96-325, Footnote 1877.

[4] SBCI's final proposed UNE loop rate averages ** **. Schedule ELP-R2 of SBCI Exhibit 1.1 (Panfil Rebuttal) shows that SBCI's proposed UNE loop rates are $9.03 in Access Area A, $17.82 in Access Area B and $20.56 in Access Area C. In SBCI's response to AT&T Data Request JG 15.21, SBCI indicated that ** ** of its access lines are in Access Area A, ** ** of the lines are in Access Area B, and ** ** of the lines are in Access Area C. See AG Direct Testimony Schedule WDA-3, where the **$ ** average rate would be the 8th highest on the nationwide list of UNE loop rates. The UNE loop rate study upon

SBCI to have one of the highest UNE loop rates in the country, when SBCI's costs for providing the necessary loops is one of the lowest in the country, is clearly not reasonable

III. UNE Loop Recurring Cost Studies.

A. Major Inputs To Cost Studies.

1. Fill Factors:

It is important to consider the larger picture when evaluating the role and importance of fill factors in this case. Fill factors are a rate multiplier. After all other arguments about what constitutes a proper TELRIC rate are resolved, the resulting rate is increased by applying the fill factor. The lower the fill factor, the greater the resulting rate increase. The significance of this adjustment cannot be overstated. The fill factor alone, independent of any other adjustment, can double the prices that CLECS have to pay for UNEs.[6]

a. The AG's proposal to use fill factors adopted by the FCC's synthesis model is the only example of a forward looking fill factor in the record in this proceeding.

When confronted with the problem of determining forward looking fill factors, the FCC, after extensive analysis, with data and input provided by numerous parties, ordered that the fill factors contained in its "Synthesis Model" be used for its forward looking cost model for the purpose of determining required universal service support

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which Schedule WDA-3 is based (*A Survey of Unbundled Network Element Prices in the United States January 2003*), was updated in January 2004. SBCI's proposed average UNE loop rate of **$ ** would be the 7th highest loop rate nationwide according to the January 2004 study.

[6] For example, if one unit of something costs $10, a 50% fill factor means the rate must be at least $20 (to pay for one unit in service, plus one spare) At a 33.3% fill factor, the rate would have to be at least $30 (to pay for one unit in service, plus two spares). No parties propose a 100% fill factor, but the determination of the factor greatly impacts the price. The importance of fill factor to SBC is evidenced by the fact that it is one of the two inputs that SBC specifically included in its attempt to set UNE rates legislatively via Senate Bill 885 during the Summer of 2003.

levels.[7] Though the FCC presented the Synthesis Model for use in determining the need for Federal High Cost Model support, rather than UNE costs, it is an example of fill factors developed in a forward looking cost model. AG Ex. 1.3 at 16.

Schedule WDA-14, submitted with the AG's Direct Testimony in this proceeding shows the applicable FCC Synthesis Model Fill Factors by wire center density. Schedule WDA-RJ5 submitted with the AG's March 5th, 2004 Surrebuttal Testimony shows the results of applying those factors to the actual SBCI densities in Illinois, and shows the weighted average of the FCC Synthesis Model fill factors correspond to zones A, B, and C in SBCI's Illinois service territory.

The FCC Synthesis Model fill factor proposal advanced by the AG should be adopted because it is the only fill factor proposal that reflects the FCC prescribed forward looking model concept, rather than trying to extrapolate forward looking costs from SBCI's existing network to a hypothetical network, or trying to establish that SBCI's existing current network is allegedly the same as a "forward looking" model. The FCC model correctly incorporates the effects of density and other factors, and represents and objective, FCC approved approach to fill factors. For these reasons, the AG's fill factor proposal should be adopted.

By presenting its current actual fill factors as the "forward looking" factors on which to base UNE rates, SBCI asserts that the level of fill currently found in its network is the same as the fill level a hypothetical, forward looking, efficient network model would have. Essentially, SBCI is claiming that it's current network is as good as it gets, and that its efficiency couldn't be improved, even if it was built in the same place, but

[7] FCC Tenth Report and Order, CC Docket No. 96-45, 97-160, Adopted October 21, 1999.

from the ground up using the best technology available today. The AG, and all other parties to this proceeding other than SBCI reject this claim.

SBCI's network is not constructed using the most current technology or practices. The record demonstrates that many engineering assumptions currently used by SBCI and its predecessors have been in use and have remained unchanged for decades.[8] The embedded current network may have a large number of lines to areas that in the past contained large customers, but which areas are now vacant or demolished. Those unneeded lines are spare lines in the embedded, current fill factor, but an efficient forward looking model would not include a large number of unneeded lines to such location. In addition, the nature of SBCI's Centrex service requires that SBCI maintain a high level of spares in order to offer that service. For example, for a PBX customer that uses 22 lines, SBCI must have 178 spares available in order to offer that customer conversion to Centrex. AG Ex. 1.2 at 9. There is no reason that UNE rate should support spare capacity that is caused by the SBCI Centrex service. It is absurd to assume that the amount of unused capacity, or nearly any other characteristic that exists in the current network, which was developed bit by bit over the past century, would exist unchanged in a brand new forward looking network constructed today using the best available technology and customer locations.

Staff discussed, but did not use, a fill factor concept which differs from SBCI's and the CLECs in that it starts with the FCC's methodology and works toward a number rather than starting with a number (actual fill or network capacity) and working toward explaining how that number should be changed to comply with TELRIC. Unfortunately,

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[8] SBCI Exhibit 8.1 at 5.

Staff does not propose a number based on its fill factor concept. Instead Staff's proposed distribution and feeder fill factor starts with SBC's proposed "embedded" fill factors, and makes one modification to each of distribution and feeder. Consequently, unlike its proposed fill factor concept, Staff's fill factor proposal starts with an embedded fill factor, makes one adjustment, and then tries to explain how the result is TELRIC compliant, rather than the other way around.

SBCI does not satisfactorily explain why the "fill" levels found in their current network will be the same as those that would be built into a hypothetical, forward looking "most efficient" network. Instead, SBCI points to the difference between projected fills in a hypothetically efficient network proposed by other parties and their current network, emphasizes how large those differences are, and claims that the differences are unrealistically large, so they must be disregarded. Of course the differences are large! They should be since they represent, on the one hand, fill levels in a decades old network developed bit by bit with whatever technology was available at the time, and on the other hand the vision of a hypothetical "most efficient" network built with state of the art equipment and with advance knowledge of customer locations and demand.

This hypothetical, forward looking, efficient TELRIC network standard is the standard against which the FCC determined that SBCI's network should be measured for the purpose of establishing UNE rates. The FCC's synthesis model provides guidance on how that analysis should be done and demonstrates that a key factor, i.e. customer density, should lead to the fill factor recommended by the AG. Accordingly, SBCI and Staff's fill factor proposals should be rejected because they do not reflect the factors

necessary to fairly and properly determine the fill factors that are an essential component of TELRIC rates.

b. SBCI's and Staff's fill factor proposals leave room for non-existent growth in demand.

As demonstrated above, the demand for telephone lines is *** ***.[9] Since the demand is *** **, there is no need to include any significant amount of additional capacity in a fill factor calculation to account for future growth. Consequently, no matter what method or concept is used to calculate the fill factor eventually used to determine TELRICs in this proceeding, if that fill factor effectively includes significant spare capacity in anticipation of future increases in demand, the fill factor is inaccurate and too low.

Both SBCI's and Staff's fill factor proposals include significant spare capacity for assumed future demand growth and are consequently too low. Comparing SBCI's, Staff's, and the AG's proposed distribution fill levels for Zone C as an example helps to illustrate this point. SBCI's proposed fill factor for distribution in Zone C is *** ***.[10] This fill factor, divided into SBCIs' current *** *** would result in the assumed construction of *** ***lines per living unit in zone C in the model[11]. Since only*** *** lines per living unit are now in use, and the evidence (as discussed above) does not show *** ***, this is an excessive and unneeded level of spare capacity. Staff's proposed fill factor for distribution in Zone C is *** ***. This fill

[9] See Supra at Section II (B.)(1.)
[10] AG Ex. 1.3 at 8. See Also SBCI's Actual Fill Study *IlCurrentFillData2002 (Jan02).xls*
[11] *** ***.

factor, divided into the current *** [12]*** would result in construction of *** *** lines per living unit in zone C in the model[13]. Since only *** *** lines per living unit are now in use, and the evidence does not show *** ***, this is an excessive and unneeded level of spare capacity.

Conversely, AG's March 5, 2004 Surrebuttal testimony proposes an FCC based fill factor of *** *** for distribution in Zone C.[14] This fill factor, divided into the same assumption of *** *** would result in construction of *** **** lines per living unit in zone C in the model.[15] Since only *** *** lines per living unit are now in use, and the evidence does not show *** **, this is an ample allowance for spare capacity. This is spare capacity of about *** *** . For example, if there were 50 homes on a particular street, there would be *** *** spare pairs down that street. If any customer wanted to add one (or two or three) lines, there would be plenty of distribution capacity.[16] Consequently, the fill factor proposal presented in the AG's March 5, 2004 Surrebuttal Testimony should be adopted because it is the only fill factor proposal in the record in the record in this proceeding that does not build capacity into the network for non-existent future demand.

The numbers in the other areas are similar to the Zone C numbers discussed above. Staff's proposed fill factors assume between ** ** distribution lines will be installed per home, despite the fact that the actual number of lines in service per home is **1 **, depending on the zone. SBCI's fill factors effectively assume ***

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[12] Staff Rebuttal Testimony Cost Model: "User Input Tab, cell D27.
[13] *** ***
[14] AG Ex. 1.3 at 13.
[15] *** **
[16] AG Ex. 1.3 at 13-14.

***distribution lines will be installed per home. AG's FCC- based fill factors effectively include *** *** distribution lines per home [17] which is more reasonable and should be adopted in setting SBCI's UNE loop rates. AG Ex. 1.3 at 8,10; 13-14, Schedule WDA-RJ3 and RJ-3.

2. Depreciation:

"Depreciation" is one of the "big three" contributors to the changes in rates SBCI is proposing in this proceeding. SBCI Ex. 1.0 at 18. SBCI claims that significant changes in the marketplace that have occurred sine its last UNE rate proceeding, and that, consequently, the depreciation lives currently included in its rates need to be updated. As is the case with fill factors in this proceeding, what constitutes proper TELRIC depreciation lives is an issue. The Supreme Court found, it its Verizon decision, that the FCC's TELRIC methodology "recognizes no particular useful life as a basis for calculating depreciation costs." On the contrary, the FCC committed considerable discretion to State Commissions on these matters."[18]

SBCI's proposed equipment lives for calculating depreciation expense are shorter than those proposed by Staff, and are shorter than the lives last approved for SBCI's UNEs[19] by the ICC. These shorter depreciation lives translate directly into higher UNE loop rates. As support for their proposed shorter depreciation lives, SBCI sponsored the testimony of Dr. Lawrence K. Vanston of Technology Futures Inc. ("TFI"). Dr. Vanston presented his forecasts of when equipment will be retired in the future. Dr. Vanston's

[17] AG Ex. 1.3 at page 10; Schedules WDA-RJ3 and RJ6.
[18] Verizon Communications, Inc., et. al. v. FCC, et al., 2002 U.S. LEXIS 3559 (U.S. May 13, 2002), at 91.
[19] AG Ex. 1.0, page 36, line 11.

claims have been specifically rejected by the FCC. [20] Additionally, Dr. Vanston's past distribution cable replacements forecasts have proven to be very inaccurate. Finally, Dr. Vanston's reports, which he cites a source material in his testimony, contain multifaceted predictions which can be used to support conflicting positions. For these reasons, the Commission should reject Dr. Vanston's proposed depreciation proposals and retain the depreciation lives it has previously approved.

Dr. Vanston claimed that the lives the ICC Ordered for use in the prior SBCI UNE cost study are "inconsistent with the FCC's TELRIC rules."[21] However, the forward looking lives the FCC itself selected for use in the FCC Synthesis Model (SM) forward looking cost study are very similar to the lives the ICC ordered for use in the prior SBCI UNE cost study. In addition, the FCC selected forward-looking lives are longer than the SBCI recommended lives. For example, the following depreciation lives are in use or proposed for the accounts in SBCI's UNE loop cost study:

THE MAJOR ACCOUNTS IN THE SBCI UNE LOOP COST STUDY[22]

	ICC Approved[23]	SBCI Proposed[24]	FCC SM
Circuit Equipment	11	9	10.24
Aerial Cable - Metallic	20	15	20.61
Underground Cable - Metallic	25	15	25
Buried Cable - Metallic	20	15	21.37
OTHER ACCOUNTS			
Aerial Cable - Non-Metallic	20	20	26.14
Underground Cable - Non-Metallic	25	20	26.45
Buried Cable Non-Metallic	25	20	25.91

[20] AG Ex. 1.0 at 38; Schedule WDA-16.
[21] SBCI Ex. 13.0 at 9.
[22] AG Ex. 1.0 at page 37.
[23] SBCI Ex. 13.0 at 9.
[24] SBCI Ex. 13.0 at 9.

For all major accounts in this proceeding, the forward looking lives that SBCI recommends are shorter (and for most accounts, are **much** shorter) than the forward looking lives that the FCC selected for the FCC forward looking SM model,[26] and that the ICC adopted in SBCI's last UNE rate case. Further, the FCC has specifically rejected the Vanston/TFI forecasts.

Dr. Vanston's claim that the Staff/ICC lives are inconsistent with the FCC forward looking lives, is incorrect. The FCC has specifically found: "There is no evidence that the large wave of plant replacements forecast by TFI, which should result in increased retirements, has begun or is about to begin."[28] It is Dr. Vanston's depreciation rates that are inconsistent with the FCC's forward-looking equipment lives.

In each of his reports published for TFI, Dr. Vanston generally makes several different forecasts about the same equipment, thereby covering all possible bases with regard to his predictions. This technique is similar issuing a report, which on one-page forecasts that Bush will win the 2004 Presidential election, but on another page forecasts that Kerry will win the 2004 election. For example, on page 34 of his Surrebuttal Testimony, Dr. Vanston points out that his 1988 forecast was that 3.3% of the residential loops would be fiber in 2003. However he does not mention that on **another page of that same** 1988 study, he forecasted that 100% of the total loop subscriber pairs would "fiber only" with no remaining metallic cable by the year 1997.[29]

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[25] AG Ex. 1.0 at 37.
[26] AG Ex. 1.0 at 37.
[27] AG Ex. 1.0 at 38; Schedule WDA-16.
[28] AG Ex. 1.0 at 38; Schedule WDA-16.
[29] AG Cross Ex. 33.

Dr. Vanston's technique of making multiple projections is further demonstrated on page 34 of his Surrebuttal Testimony. His 1994 forecast included three sets of numbers: the "early" scenario, the "middle" scenario, and the "late" scenario. However in 1994, he said the late scenario was not his projection and was "not a reasonable choice." Specifically, he said:

> Our analysis indicates that the most likely pattern of adoption for distribution fiber falls between the early and middle scenarios,"

AG Cross Ex. 32 at xi. He also said the "late" scenario is not a reasonable choice."[30] AG Cross Ex. 32 at 67. Despite the fact that he expressly disavowed the "late" scenario in his 1994 analysis, later in his testimony in the current case, Dr. Vanston highlights the "late" scenario, and discusses it in detail in the current proceeding.[31] Although his 1994 forecast had favored the "early and "middle" scenarios, he now dismisses them by saying "everyone agrees that the early and middle scenarios are not occurring."[32]

In fact none of the three scenarios contained in Dr. Vanston's 1994 study are occurring. As shown on page 34 of Dr. Vanston's Surrebuttal testimony, in the 1994 forecast, Dr. Vanston forecast that 74.2 % of the residential distribution lines would be all fiber by 2003 (early scenario) or 42.4% would be (middle scenario) or 10.7% would be (late scenario). As it turns out, 1% or less of residential distribution lines were actually all fiber in 2003, according to TFI's current data. SBCI Ex. 13 Schedule LKV-2 at Pages 79, 80, and 81.

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[30]SBCI Ex. 13.2 Schedule LKV-S1 at 92.
[31]SBCI Ex. 13.2 at 34.
[32] SBCI Ex. 31.2 at 33.

Dr. Vanston's technique of including a variety of forecasts in his analysis and then later picking and choosing among them to attempt to match telecommunications history as it unfolds is disingenuous, has been rejected by the FCC, and should be rejected by the ICC in this proceeding as well.

B. Other Loop Recurring Cost Modeling And Input Issues.

1. Other DLC investment cost issues.

a. Calculation and application of building cost factor:

Throughout this proceeding, SBCI has maintained the appropriateness of applying a "building factor" to add building costs to the cost of electronic equipment that it freely admits is not located in a building. SBCI's reasoning for applying a "building factor" for electronic equipment that is not located in a building is that SBCI's accounting system does not permit them to separate or identify costs of items that are not located within buildings.[33] Regardless of their "accounting system", their cost model in this case already has sorted out the costs of the equipment that is in a building, and the costs of the equipment that is not in a building. For example, on the SBCI study summary (Schedule WDA-R1) the description "C.O. Terminating Equipment" means that the terminating equipment is in the Central Office building. The "Remote Terminal Equipment" is not in a building. This is shown by the use of the word "remote" and the lack of a "C.O." description. Even if SBCI could not sort the investment in their model, we have done that for them, as shown on Schedule WDA-S1.

SBCI's model would erroneously charge UNE rates based on an assumption that all electronics equipment is contained in a building. However, the majority of the

[33] SBCI Exhibit 4.1 at 53.

electronics equipment used for UNE loops is not located in a building. Instead, the equipment is located in remote terminal equipment. Remote terminals are remote. They are out in the field rather than in a central office building. A metal cabinet protects the electronics equipment contained in a remote terminal. The cost of this cabinet is recovered as part of the remote terminal costs. SBCI's current cost study includes the cost of the cabinet in which the remote terminal is housed, plus added building costs, even though the cabinet (which is already charged for) serves as the "building" and there is no actual building around the remote terminal. AG Ex. 1.0 at 26-27. This "building factor" applied where there is no building, clearly inflates SBCI's proposed UNE loop rate.

SBCI witness James Smallwood's Rebuttal Testimony claims that it is appropriate to spread the total building cost across the total universe of electronic equipment investments because, "that is the way the building factors are calculated." SBCI Ex. 4.1 at 82. During cross-examination, the AG demonstrated an adjusted the calculation of the "building factor" so that only the investments that were inside a building were considered in the denominator of that calculation. The AG identified the amount of electronic equipment in each zone that is not located in buildings. (AG Cross Ex. 29P; TR at 795, 804, 805) and made the accurate calculation.

Mr. Smallwood suggests that if the building factor were applied only to electronic equipment actually located in buildings, the factor would be higher, because the total base of investment would be lower, and would net out and produce no overall change in costs. SBCI Ex. 4.1 at 82-83.

Mr. Smallwood's assertion that a change resulting from applying a "building factor" only to electronics that are located in buildings would "net out" and would "produce no overall change in costs" (SBCI Ex. 4.1 at 83) is incorrect. As the record demonstrates, such an adjustment to remove the "building factor" from electronics that are not located in buildings will reduce the per line / per month cost of 2 wire UNE Loops in Zone 3 by ** **. AG Ex. 1.1, Schedule WDA-S1. The reason the adjustment will not "net out," as SBCI claims, is that only a small portion of the electronics investment that is used for UNE loops is located inside a building. [34] Consequently, while the adjustment to remove the "building factor" from electronics equipment not located in a building may net out across SBCI's entire network, it does not net out with regard to the electronics equipment necessary to provide UNE loops. UNE loops are the only rates at issue in this case.

SBCI's "building factor" methodology, which neglects to allocate building costs only to electronics equipment located in buildings, inflates UNE loop rates by including costs for buildings at locations where there are no buildings and allocating the cost of buildings that do not house UNE related facilities to UNE rates. The Staff model has not corrected this problem, so a correction is required. That correction to the Staff model is shown on Schedule WDA-RJ1 and RJ2.

b. Remote terminal investment cost allocation:

The AG pointed out in Direct Testimony that SBCI's LoopCat cost model filed with its Direct Testimony greatly overstated costs to engineer and install remote terminals. AG Ex. 1.0 at 28. The engineering and installations costs for remote terminals

[34] AG Ex. 1.2 at 6.

included in SBCI's Direct Testimony LoopCat cost study was *** *** for the 2016 line remote terminals. SBCI's responses to discovery questions regarding remote terminal engineering and installations costs show substantially lower actual costs for engineering and installing remote terminals. AG Ex. 1.0, Schedule WDA-20. Staff also proposed reduced costs for engineering and installing remote terminals. In its rebuttal testimony, SBCI presented revised remote terminal installations costs of *** *** for 2016 line remote terminals, and of *** *** for 672 line remote terminals. Though SBCI witness Smallwood, in discussing the revised remote terminal installation costs, states that he disagrees with the AG's remote terminal installation cost recommendation, the drastic reduction in proposed remote terminal installation costs from SBCI's Direct to Rebuttal Testimony evidences agreement with the AG's and Staff's recommendation that SBCI's original cost proposal needed to be reduced, even if SBCI did not agree with the exact reduction of the or reasons for doing so. SBCI Ex. 4.1 at 71. This is no longer a contested issue, because the Staff, SBC and AG models all use the same (reduced) amounts.

2. Premises termination costs

c. Adjustment to remove double-counting.

i. The AG pointed out that a major cost component, accounting for 23% of SBCI's proposed rate increase, was not appropriate.

SBCI's Direct Testimony supporting its rate filing in this proceeding stated that 23% of the proposed rate increase it sought was necessary due to SBCI's inadvertent omission of termination equipment (e.g., building terminals, building entrance cables, and the network interface devices ("NID")) at the customer premise, and omission of

some other needed components from its "AFAM"[35] loop study, conducted in 1996. SBCI Ex. 1.0 at p. 30. SBCI was unable to present any convincing evidence that the NID and distribution costs were not included in its "AFAM" cost study. As the record demonstrates, the only evidence SBCI provided in support for this claim was that it could not find specific reference to the investments in question in its workpapers or the documentation for its AFAM study. AG Ex. 1.0 at 16.

The AG had better luck finding the NID and distribution terminal costs in SBCIs "AFAM" study than SBCI did. Schedules WDA 7 – 9 submitted with AG Ex. 1.0 demonstrate that SBCI refers to "NID" and distribution terminal costs as "exempt material, and that these "exempt material" costs were included in the AFAM cost study as "installation factors." AG EX. 1.0, at 17, Schedules WDA 7-9. Consequently, contrary to Mr. Smallwood's Direct Testimony claim, NID and distribution terminal costs were not omitted from SBCI's "AFAM" costs study.

The AG's Direct Testimony further pointed out that not only were NID and distribution terminal costs not, as SBCI originally claimed, omitted in SBC's prior "AFAM" cost study, these costs are included twice in SBCI's current LoopCat cost study filed in this proceeding. AG Ex. 1.0 at 18. The AG's Direct Testimony details how SBCI's LoopCat cost study includes the material, installation, and engineering costs of NIDs, distribution drop wires, and distribution terminals as both "exempt" materials within the LoopCat installation factors, and again as "Premise Termination" or Distribution Terminal" costs. AG Ex. 1.0 t 18-25, Schedules WDA 7,7,11,12,13. The AG's Direct Testimony also quantifies the impact of this double counting by calculating

[35] AFAM is SBCI's former cost study used to develop costs in its last UNE rate proceeding.

the impact of including the costs within the LoopCat installation factors (AG Ex. 1 at 21), and recommends a method to remove the double counting from the LoopCat cost study. AG Ex. 1 at 25.

ii. SBCI accepted these adjustments and revised their cost studies accordingly.

SBCI agreed with the AG that NID and Distribution terminal costs were double counted in the LoopCat cost study. SBCI Ex. 4.1 at 85. SBCI's rebuttal testimony states that it took steps to correct its LoopCat study to remove this double counting. SBCI Ex. 4.1 at 6, 86. The AG's surrebuttal testimony filed on February 20, 2004 pointed out that the method SBCI suggested to remove the double counting of NID and Distribution Terminal costs from its LoopCat costs study, though not the exact method recommended by the AG, would solve the problem. AG Ex. 1.2 at 3-4. These corrections account for two of the seven changes SBCI made in response to the multitude of suggestions it received from the ICC Staff and Intervenors regarding its LoopCat cost study. It is fair to assume that if the AG's witness had not helped SBCI to understand how the NID and Distribution Materials were double counted in SBCI's LoopCat study, this double counting would have remained, and would have been included in rates eventually adopted in this proceeding.

The AG's Surrebuttal Testimony to Staff and Intervenors, filed on March 5, 2004 identified one additional minor correction that must be made to Staff's corrected version of SBCI's LoopCat cost study to complete the removal of the NID and Distribution Terminal double counting. This correction is necessary because of what appears to be a data entry error in Staff's adjustment to SBCI's LoopCat model to remove the NID and

Distribution Terminal double counting. As the AG pointed out in its March 5th, 2005 Surrebuttal Testimony,

> In its calculation of its modified installation factor for buried metallic (copper) cable, Staff input the SBCI updated data from the SBCI rebuttal testimony workpapers. However, Staff inadvertently failed to input this revised data for, "Sundry and Misc, Expense" for the buried metallic (copper) cable.[36] I corrected this by inputting the new "Sundry and Misc. Expense" data from SBCI's Rebuttal Testimony.[37] The impact of this correction is shown in the second column of Schedule WDA-RJ2, for the 2 wire, Zone 3 UNE Loop. This correction is also included in Schedule WDA-RJ1 for all the UNE loops.

AG Ex. 1.3 at 5. Staff's correction is incomplete. The corrected data needs to be entered to complete the removal of double counted NID and Distribution Terminal costs. The impact of this correction is shown in Schedule WDA-RJ1and RJ2 presented with the AG's March 5th, 2004 Surrebuttal Testimony. The Commission should factor these corrections into the final UNE rates allowed in this proceeding.

IV. -Recurring Cost Studies And Rate Designs.

A. Provisioning (Loops and EELs) Nonrecurring Cost Studies:

1. Occurrence probabilities:

SBCI's "occurrence factors" that designate how often physical wiring connection work has to be done for certain types of service orders, appear to have no valid basis in fact. AG Ex. 1.0 at 45-49. These "occurrence factors" are inputs used in SBCI's non-recurring costs studies presented in its Direct Testimony. The AG's Direct Testimony

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[36] Staff clearly meant to use this SBCI Rebuttal data for the buried cable "Sundry and Misc. Expense." For Aerial Metallic Cable the Staff workpapers indicate that Staff used SBCI's Rebuttal data for "Sundry and Misc. Expense" in its calculation of its modified installation factor for aerial metallic cable.

[37] This new replacement data comes from SBCI's workpapers provided to parties with its January 20, 2004 filing. This data replaces the data contained on Staff Ex. 23.0 (Lazare Rebuttal Testimony), Schedule 1R, page 5 of 8.

demonstrates that one of these "occurrence factors" assumes that physical central office wire connection work will be required on over *** *** of the new UNE-P installations that SBCI makes. Another "occurrence factor" designating the percentage of time physical wiring changes are needed for "stand-alone UNE loops" and "New UNE-P" assumes that such physical wiring changes are necessary ** *** of the time. AG Ex. 1.0 at 48. These percentages should reflect the percentage of the time that actual physical wiring work must be performed. However, SBCI responded to discovery questions propounded by the AG asking about this percentage as follows:

> (a) SBCI does not track the percent of "stand alone" UNE loops where the end user has a fully established loop facility from their premises to the serving central office.
>
> (b) SBCI does not track the percent of UNE-Ps that were actually physically provided under circumstances where the end user has a fully established loop facility from their premises to the serving central office.

AG Ex. 1.0 at 47-49. In other words, SBCI stated that they did not keep track of what percentage of stand-alone UNE-P and new UNE-P customers already had all in place necessary wires for telephone service from their premises to the central office. For customers who do have all necessary wiring in place, physical wiring changes are not required. Rather than tracking the actual percentage, SBCI applied a factor based on the percentage of its plant that is not connected through to a switch. SBCI Ex. 6.0 at 19.

The factor SBCI used is similar to a "spare" factor. However, when an existing customer moves out, or otherwise disconnects service, the telephone company normally does not physically disconnect the lines to that location. When a new customers moves in, or other service is ordered at that location, new physical connections do not need to be made. It does not matter how much "spare" capacity there is in the network, the existing

physical connection is used, which does not require a physical wiring change. AG Exhibit 1.0 at 46-48.

In applying this factor, SBCI assumes that the percent of lines for which a new physical connection is required is equal to the percent similar to the percentage of "spare" lines that are not connected through to a switch. The occurrence percentage SBCI uses in its costs study is based on this assumption rather than on any analysis of the actual percentage occurrence that exists. AG Ex. 1.0 at 49.

V. Shared And Common Factors.

A. Common Cost Factor.

1. Merger savings:

When SBCI merged with Ameritech, CLECs in Illinois were supposed to receive a benefit of reduced rates resulting from the merger. The ICC's Order approving the SBCI / Ameritech merger directed that merger savings be shared with retail ratepayers and that merger savings be passed on to wholesale customers through updated rates including reductions to shared and common costs.[39] The promised savings have not materialized. Instead, as SCBI Witness Panfil testified, SBCI's shared and common overhead costs have increased since SBCI's last rate case, and this increase accounts for 22% of the proposed rate increase SBCI presented in its Direct Testimony. SBCI Exhibit 1.0 at 21. The absence of merger savings related reductions to shared and common costs calls into question the credibility of SBCI's proposed shared and common costs

[39] ICC Docket 98-0555, Order at p. 150.

increases. The record demonstrates that SBCI has overstated these costs, as discussed more thoroughly by Staff and other parties.

B. Shared Cost Factor.

1. Definition of wholesale shared costs:

2. Uncollectible expense:

SBCI's shared and common cost factor includes a proposed wholesale uncollectible revenue factor that is artificially inflated. SBCI used a wholesale uncollectible factor of over *** ***. However their actual data shows a wholesale uncollectible rate of less than*** *** AG Exhibit 1.0 at 43; Schedule WDA-4. Staff used an uncollectible rate of *** ***, which is much closer to SBCI's actual data.

The wholesale uncollectible revenue factor is supposed to indicate what percentage of SBCI's wholesale revenues they are unable to collect. Ordinarily, the uncollectible rate is determined by dividing the uncollectible wholesale amount by total wholesale revenue. Ag Ex. 1.2 at 17. This is the proper way to calculate the uncollectible factor because that factor is an expression of what percentage of wholesale revenue SBCI is not able to collect. Instead of calculating its wholesale uncollectible factor in this manner, SBCI divides the wholesale uncollectible amount by its wholesale costs.

SBCI calculated wholesale costs (*** ***), which are much lower than its wholesale revenues (*** ***). Therefore, dividing by the much lower cost figure, results in a wholesale uncollectible factor that is both wrongly derived and grossly overstated. Dividing the wholesale uncollectible amount by this lower wholesale cost

number will produce a higher, inaccurate, and inflated uncollectible factor. This improperly derived figure should be disregarded.

The *** *** uncollectible factor used to develop Staff's proposed UNE rates is much closer to SBCI's actual Illinois wholesale uncollectible percentage reported in discovery in this proceeding and therefore should be adopted.

VI. Imputation and Price Squeeze:

a. As Staff, the AG, and other Intervenors Have Consistently Testified, SBCI's Proposed UNE Loop Rates Will Fail the "imputation test" in Illinois law.

As the AG pointed out in Direct Testimony, and as SBCI readily admitted, under SBCI's initial proposed UNE loop rates, SBCI's retail business access rates would fail the imputation test, and, consequently, would have to be increased. SBCI has testified that it will, "make whatever adjustments may be required to its business service rates" if they are found to not pass the imputation test based on the rates ultimately approved by the ICC in this proceeding. SBCI Ex. 1.0 at 23. SBCI's small business rates are capped by statute through July, 2005. 220 ILCS 5/13.502.5(b).

Staff Witness Koch testified that the an increase of over $200 million annually in retail business access line rates would be necessary for those rates to pass imputation if SBC's initial proposed UNE loop rates were approved. Staff Ex. 4.0 at 37. In his Rebuttal Testimony, Staff witness Koch stated that he modified his imputation analysis due to changes in SBCI's and Staff's proposed UNE loop rates, but that his conclusions that SBCI's proposed UNE rates will cause their retail competitive business access rates to fail imputation and that Staff's proposed UNE rates will not, remain largely unchanged. Staff Ex. 24.0 at 2.

b. Like Staff's proposed UNE loop rates, the proposed UNE Loop rates contained in the AG's March 5th, 2004 Surrebuttal Testimony will pass the imputation test.

In its March 5th Surrebuttal testimony, the AG presented proposed UNE rates that were a modified version of Staff's proposed UNE rates. The AG modified rates were slightly lower in each case that Staff's proposed UNE rates for each loop type.[40] Since the UNE loop rates presented in the AG's March 5, 2004 Surrebuttal Testimony are each lower than the proposed UNE rates Staff presented in its March 5, 2004 Surrebuttal Testimony, and since Staff's proposed UNE rates were all shown to pass the imputation test, it is a mathematical fact that the lower rates presented by the AG will also pass imputation.[41] Therefore, no increase is small business rates would have to be considered if the AG's proposed rates are adopted in this case.

[40] The modifications is the result of correcting what the AG assumes is a data entry error in Staffs update of its proposed UNE rates to remove double counting of NID and Distribution Terminal costs in SBCI's LoopCat Study. This modification is described in greater detail Supra at 23.
[41] AG Ex. 1.3 at 17.

CONCLUSION

Therefore, for the reasons stated above, the People of the State of Illinois request that the Commission adopt UNE loop rates consistent with the argument presented herein.

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Respectfully submitted,
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